

DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER 95-0365 INC.

Gross Income Tax and Adjusted Gross Income Tax

For The Periods: July 31, 1984 Through And Including July 31, 1992

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

1. **Gross Income Tax - Leased Vehicles**

Authority: IC 6-2.1-2-2(a)(2); IC 6-2.1-3; IC 6-2.1-4; IC 6-2.1-1-13; Indiana-Kentucky Elec. Corp. v. Indiana Dep't of State Revenue, 598 N.E.2d 647 (Ind.Tax 1992); First National Leasing and Financial Corp. v. Indiana Dept. of State Revenue, 598 N.E.2d 640, 644 (Ind.Tax 1992); Department Regulation 45 IAC 1-1-49.

The taxpayer protested the assessment of gross income tax on income from leased vehicles situated in Indiana.

2. **Adjusted Gross Income Tax - Leased Vehicles**

Authority: IC 6-3-2-1(b); IC 6-3-2-2; 45 IAC 3.1-1-38(5)

The taxpayer protested the assessment of adjusted gross income tax on income from leased vehicles situated in Indiana.

3. **Negligence Penalty - Imposition**

Authority: IC 6-8.1-10-2.1(e); 45 IAC 15-11-2©

The taxpayer protested the imposition of the ten percent negligence penalty.

STATEMENT OF FACTS

The taxpayers is a nonresident corporation engaged in leasing fleets of vehicles. The taxpayers has no employees in Indiana. All leases are negotiated and executed outside of Indiana. Lessees have control over the use of vehicles. The taxpayer titles and registers the vehicles in Indiana. The vehicles are titled and registered in taxpayer's name. The taxpayer paid Indiana sales tax on the leased vehicles delivered, titled and registered in Indiana. Maintenance of vehicles is the responsibility of the lessees and warranty coverage is with the manufacturer of the vehicles. After a lease is executed, the taxpayer usually orders the vehicle from the manufacturer. The manufacturer delivers the vehicle to a dealership located near the taxpayer's customer at the direction of the taxpayer.

The taxpayer did not file Indiana corporate income tax returns for the years at issue.

The taxpayer protested the assessment of gross income tax, adjusted gross income tax, and penalty on its lease receipts from vehicles, titled, registered and located in Indiana.

1. **Gross Income Tax - Leased Vehicles**

DISCUSSION

With respect to nonresident taxpayers, Indiana gross income tax is imposed under IC 6-2.1-2-2(a)(2), which provides the following:

- (a) An income tax, known as the gross income tax, is imposed upon the

receipt of:

...

- (2) The taxable gross income derived from activities or businesses or any other sources within Indiana by a taxpayer who is not a resident or a domiciliary of Indiana.

The Indiana Tax Court has interpreted and applied this statute using a three-step analysis: (1) are the receipts "gross income", (2) is the gross income derived from "sources within Indiana," and (3) is the gross income that is derived from sources within Indiana "taxable gross income"? Indiana-Kentucky Elec. Corp. v. Indiana Dep't of State Revenue, 598 N.E.2d 647 (Ind. Tax 1992).

Both the taxpayer and the department agree that the income in question is gross income. The taxpayer alleges that the income is not Indiana source income. In First National Leasing, the court stated that “the use of the word ‘operation’ in the regulation 45 I.A.C. 1-1-49(6) indicates an active participation in the listed activities of ‘ownership, leasing, or rental’ is necessary for the establishment of a ‘business situs’ in Indiana.” Id. at 644. In First National Leasing, the taxpayer was not involved in locating the tangible personal property in Indiana. However, in this case, the taxpayer delivers or has the manufacturer deliver the leased vehicles to lessees in Indiana. The vehicles are titled and registered in Indiana. Both titles and registrations to the vehicles are in the taxpayer’s name. Each year the vehicles are registered by the taxpayer. Therefore, the taxpayer controls initially the location of the vehicle and remits excise tax in lieu of property tax to the state of Indiana. These factors constitute the establishment of an Indiana business situs under 45 IAC 1-1-49, because the taxpayer actively participates in the location of the property in Indiana.

However, under First National Leasing, an Indiana “business situs” is not sufficient by itself to impose tax on a non-resident’s income. The “business situs” must be the “tax situs” of the income generated by the leasing transaction. As was stated in First National Leasing, “the purpose of a lease is to transfer for consideration certain rights in property, generally use and possession.” The “use and possession” of the property that is the subject of the lease is transferred in Indiana from the taxpayer to the lessees. Because this activity is the primary purpose of the lease, it is more than minimal and establishes the Indiana “business situs” as the “tax situs” of the income generated by the leasing transaction.

The final issue is whether or not the agreed gross income is taxable gross income under IC 6-2.1-1-13. IC 6-2.1-1-13, defines “Taxable gross income” as all gross income which is not exempt from tax under IC 6-2.1-3; less (2) all deductions which are allowed under IC 6-2.1-4. The taxpayer’s lease income is not exempt from gross income tax under IC 6-2.1-3 and is not subject to any deductions under IC 6-2.1-4.

Because the taxpayer is directly engaged in locating the property in Indiana and in fact transfers the

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use and possession of the property in Indiana, its gross income from the lease of such property is subject to tax, and the taxpayer’s protest is therefore denied.

2. **Adjusted Gross Income Tax - Leased Vehicles**

DISCUSSION

As provided under IC 6-3-2-1(b), Indiana adjusted gross income tax is imposed on “that part of the adjusted gross income derived from sources within Indiana of every corporation.” Further, the following is provided under IC 6-3-2-2:

- (a) with regard to corporations and nonresident persons, “adjusted gross income derived from sources within the state of Indiana”, for the purposes of this article, shall mean and include:
 - (1) income from real or tangible personal property located in this state; [and]
 - (2) income from doing business in this state[.]

The leased property is located in the state of Indiana. Under 45 IAC 3.1-1-38(5), the rental of property in Indiana is an activity sufficient to establish nexus for imposing the Indiana adjusted gross income tax. Therefore, the taxpayer is subject to the adjusted gross income tax and its income is apportionable under IC 6-3-2-2.

For purposes of apportionment, the taxpayer argues that the leased vehicles belong in the lessee's property factor, rather than in The taxpayer's, in computing adjusted gross income tax. The Department disagrees. As the owner of the vehicles which are generating the income, The taxpayer is required to include the vehicles in its property factor. The taxpayer is correct that lessees will also be required to report the vehicles in their property factor. However, this is for apportionment of each taxpayer's income. The relevant statutory provision reads as follows:

The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the taxable year and the denominator of which is owned or rented and used during the taxable year. . . . IC 6-3-2-2(c).

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The taxpayer argues that the above statute requires that two tests must be met: 1) The taxpayer must own or rent the property in question; and 2) The taxpayer must use the property in Indiana. "Use" means the exercise of any right or power of ownership over property. The taxpayer owns the property and uses it in Indiana when it leases the property in Indiana to another party. Therefore, the original cost of the property would be included in the taxpayer's property factor.

FINDING

The taxpayer's protest is denied.

3. Negligence Penalty - Imposition

DISCUSSION

The negligence penalty imposed under IC 6-8.1-10-2.1(e) may be waived by the Department where reasonable cause for the deficiency has been shown by the taxpayer. Specifically:

The department shall waive the negligence penalty imposed under IC 6-8.1-10-2 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. 45 IAC 15-11-2(c).

Taxpayer has failed to establish reasonable cause for the deficiency remaining after the adjustments required by this letter.

FINDING

The taxpayer's protest is denied.

CONCLUSION

The taxpayer's protest is denied.

